November 19, 2012

Hunter College Graduate Program Economics Department, 695 Park Avenue, New York, NY 10065

Office of the Secretary, PCAOB,  
1666 K Street, N.W., Washington, D.C. 20006-2803

Re: Concept Release on Auditor Independence and Audit Firm Rotation, PCAOB Rulemaking Docket Matter No.37

To Whom It May Concern:

The Advanced Auditing class (Eco 775) at Hunter College Graduate program in New York City appreciates the opportunity to comment on this important topic.

The class discussed the above Invitation to Comment and offers the attached response to questions for respondents and feedback.

If you would like additional discussion with us, contact Professor Joseph A. Maffia, at 212-792-0404.

Sincerely,

Professor Joseph A. Maffia, CPA
Hunter College Graduate Program Economics Department
Advanced Auditing Class Eco 775

Invitation to Comment Concept Release on Auditor Independence and Audit Firm Rotation

November 19, 2012

Hunter College Advanced Auditing Class Principal Drafters

Alyssa Borenstein
Qin Chen
Helen Chiu
Brian Choi
Ngawang Choney
Charles Gerstman
Natallia Krapiunitskaya
Sagirah Layne
Tracy Leong
Anthony Licandro
Melinda Ling
Krista Littman
Jacquelyn Nolasco
Yonah Novick
Zhouyao Pan
Susanna Pangestu
Siriporn Parnsomboon
Gennadiy Privalov
Joanna Ramnarine
Ruben Rodriguez
Stredella Scott
Evis Shehu
Alexandra Tartell
Anisa Teodori
Kurt Yuen
Xin Zhao

Professor Joseph A. Maffia, CPA
RESPONSE TO THE INVITATION TO COMMENT (ITC)
Concept Release on Auditor Independence and Audit Firm Rotation

The Advanced Auditing Class has reviewed the above-referenced ITC and offers the following feedback for consideration by the Public Company Accounting Oversight Board.

Response to Particular Questions – for the sake of brevity we did not repeat the question and we skipped those questions for which we had no substantive comment:

1) 5-10 years would be an appropriate term length. A five year period would provide enough time for an auditor to gain enough experience. A term over 10 years may create a likelihood of impairing independence.

In general, we do not accept audit firm rotation but if the mandatory process is implemented we think that at least 10 years should be an appropriate term length. Mandatory firm rotation will negatively affect audit quality since new audit firm needs a few years to gain understanding and become familiar with the company, industry and processes. Therefore, in order to eliminate a risk of audit failures, the length term should be as longer as possible up to ten years.

2) Larger entities should have longer terms, since they may have more complex structure for an auditor to fully understand. Industries that are prone to fraud should also have longer terms because they maybe complex as well.

3) In the beginning, audit effectiveness depends on the size of the company and type of business. If the CPA firm has experience in
the industry then the "learning curve" may be shorter. But overall, 5 years should be enough to become familiar with an entity’s industry and business structure. When the auditors has been engaged for a long period of time with the same client, they may become too complacent, over confident and may overlook many material aspects that may have been immaterial in previous audits.

6) No. Since audits should be objective, the rotation should be required equally for any firm sizes and any firm style. Therefore, rotations should not be industry specific. By being industry specific, it can show signs of being bias.

7) Not every audit firms have an expertise or skills in all kind of business types. If the business nature is very complicated, it might be hard for them to find a skilled audit firm.

For smaller CPA firms, they may have their own limitations on human resources and funds that cannot satisfy the qualification to audit the public company. They also need to sign an audit engagement with the companies to make sure if they can be re-engaged.

8) Because as mentioned in the concept release, the auditor will have an incentive to build a relationship with the client while performing an audit, so that at the end of the audit, the client can hire the auditor to perform non-attestation services. If the management of the company is still a decision maker, approver, etc., then any CPA can be involved in non-attestation engagements.

10) It depends on the size of the firms. There are firms like E&Y that have offices all over the world and they can provide audit services easily from the location where financials are prepared. But for smaller audit firms, the travel cost, language differences
and local accounting or auditing regulations all can be unique challenges.

12) If an audit firm is short of resources, it will not be able to perform the audit and will engage in a non-audit service. Nonetheless, the quality of the services still must stay the same because they carry responsibilities for provided services.

13) There may be an increase in competition on the market for non-audit services. This increase will be beneficial to investors since the service providers will have to provide higher quality services, reduce prices, or both.

14) Opinion shopping will happen regardless if auditor rotation happens or not. If audit firm rotation is a mandatory, clients will face more and more firms and have more options for opinion shopping. Clients will be able to analyze different firms, CPAs from cost-benefit perspective. Clients always want a firm that is easy to deal with, and the firms most likely to retain the clients, so the opinion shopping would be more.

15) A rotation may increase the competition for audit engagements. Audit firms can no longer depend on audit clients for consistent cash flows after mandatory rotation is required. A higher competition for audit engagements will most likely increase audit quality.

16) 1. Higher focus on internal controls;

2. Communication between predecessor and successor auditors;

3. Increasing human resources and new business training resources;

4. Developing the non-audit service business.

17) Currently, more research should be done to find the close relationship between fraud and term of audit-client relationship.
The concept release mentions “that fraud is more likely in the early years of an auditor-client relationship.” However, argue that this is a post hoc fallacy (correlation does not imply causation). The concept release mentions of studies that have been done, but these studies deliberately target audits with high risk. Therefore, further studies are needed on this issue.

19) At the first two years of the rotation, the CPA firm should make sure an experienced, professional personnel that is familiar with the industry is monitoring an audit in order to reduce the audit failure rate. Appropriate training programs and webinars are provided to all personnel assigned to the audit. Assign more auditors to the audit process to reduce the audit failure rate.

20) It should not be a restriction if a client needs to remove an auditor before a fixed term. Currently, audit engagements are done on a yearly basis and do not necessarily have a set number of terms. Having this freedom enables the client to look for an auditor that can perform high quality audits. One problem that arises from this provision is opinion shopping. Companies may choose to shop around until they found an auditor that will give an unmodified report.

21) 1. The board should give an option to not rotate for 1 or 2 years so that sufficient preparation can be achieved.

2. The board should specify whether all audits will start as first-year audits or if the audits will be counted from the first year the engagements began.

3. The board must address CPAs that may move to a different firm and audit a client whom they had audited previously as a CPA of the previous firm. The board must keep track of both firms and CPAs as well.